

## Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 EURE-00 SSO-00 NSCE-00 INRE-00

USIE-00 AGR-20 CEA-02 CIAE-00 COME-00 DODE-00 EB-11

FRB-02 H-03 INR-10 INT-08 L-03 LAB-06 NSAE-00 NSC-07

PA-04 RSC-01 AID-20 CIEP-02 SS-20 STR-08 TAR-02

TRSE-00 PRS-01 SP-03 FEAE-00 OMB-01 SWF-02 DRC-01

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O R 211502Z JUN 74

FM AMEMBASSY PARIS

TO SECSTATE WASHDC IMMEDIATE 0150

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY ROME

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

AMCONSUL BORDEAUX

AMCONSUL LYON

AMCONSUL MARSEILLE

AMCONSUL NICE

AMCONSUL STRASBOURG

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PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: PROSPECTS FOR FRENCH ECONOMIC STABILIZATION  
PROGRAM

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REF: PARIS 14374

1. SUMMARY. DURING INTERVAL OF FRENCH PRESIDENTIAL ELECTIONS FRENCH ECONOMIC POSITION DETERIORATED. NEW GISCARD GOVERNMENT THUS MOVED RAPIDLY TO PUT TOGETHER STABILIZATION PROGRAM WITH TWIN OBJECTIVE OF BRINGING INFLATION UNDER CONTROL WITHIN 12 MONTHS AND RESTORING EXTERNAL PAYMENTS EQUILIBRIUM WITHIN 18 MONTHS (REFTEL). PROGRAM HAS SOME BITE AND, AS IT TAKES HOLD, IT SHOULD MOVE ECONOMY IN DIRECTION OF STATED OBJECTIVES. HOWEVER, THESE OBJECTIVES LOOK TO US TO BE TOO AMBITIOUS FOR MEANS BEING EMPLOYED. MOREOVER, GOVERNMENT WILL HAVE TO DISPLAY GREAT AGILITY TO AVOID CONFLICT BETWEEN ITS GOALS IN FIELD OF SOCIAL REFORM AND ITS ECONOMIC STABILIZATION EFFORT. END SUMMARY.

2. TO SET THE STAGE, SINCE POMPIDOU-GISCARD ECONOMIC PROGRAM WAS ELABORATED IN LATE DECEMBER AND EARLY MARCH, FRENCH ECONOMIC POSITION HAS UNQUESTIONABLY DETERIORATED. PRICES HAVE BEEN CLIMBING AT 18-20 PERCENT A YEAR. IT WAS ALWAYS EXPECTED, OF COURSE, THAT CONSUMER PRICE INDEX WOULD SHOW A STEEP RISE IN EARLY 1974, AS OIL PRICE INCREASES WERE ABSORBED INTO PRICE STRUCTURE. HOWEVER, PERHAPS IN PART BECAUSE OF DRIFT DURING ELECTORAL PERIOD, THIS HEAVY RATE OF INCREASE STILL ENDURES. FINANCE MINISTER FOURCADE SAYS THERE WILL BE MORE BAD RESULTS IN MONTHS IMMEDIATELY AHEAD. TRADE AND CURRENT ACCOUNT DEFICITS FOR 1974--EARLIER PROJECTED AT \$3.5-4 BILLION RANGE--HAVE NOW SWOLLEN IN SOME ESTIMATES TO AS MUCH AS \$6 BILLION. IT WAS AGAINST THIS BACKGROUND THAT NEW FRENCH GOVERNMENT PUT TOGETHER PACKAGE OF STABILIZATION MEASURES ANNOUNCED ON JUNE 12 AND DESCRIBED IN REFTEL.

3. THERE IS NO DOUBT THAT NEW PROGRAM HAS SOME BITE AND, AS IT TAKES HOLD, IT SHOULD HAVE MODERATING EFFECT ON PACE OF DOMESTIC INFLATION AND ON MAGNITUDE OF EXTERNAL DEFICIT. WHAT STANDS OUT THE MOST, HOWEVER, IS NOT SEVERITY OF MEASURES ADOPTED. IT IS RATHER AMBITIOUS NATURE OF TARGETS SET: PRICE INCREASES ARE TO DECLINE LIMITED OFFICIAL USE

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FROM AN ANNUAL RATE OF BETTER THAN 18 PERCENT IN THE FIRST FOUR MONTHS OF 1974 TO 12 PERCENT BY END OF THIS YEAR, AND TO 6 PERCENT BY MID-1975. EXTERNAL DEFICIT IS TO BE CUT IN HALF BEFORE MID-1975 AND TO MELT AWAY ENTIRELY BY END OF NEXT YEAR. OUR CONCLUSION IS THAT THESE OBJECTIVES ARE TOO AMBITIOUS FOR MEANS BEING EMPLOYED.

4. IN ADDITION, FIGHTING INFLATION CAN, AND DOUBTLESS  
WILL, COME INTO CONFLICT WITH OTHER HIGH PRIORITY  
OBJECTIVES OF FRENCH GOVERNMENT--NOTABLY, MAINTAINING  
ECONOMIC GROWTH AND HIGH LEVEL OF EMPLOYMENT AND  
IMPROVING THE LOT OF UNDERPRIVILEGED GROUPS IN FRENCH  
SOCIETY. TO TAKE AN EASY EXAMPLE, INCREASING TAXES  
ON PERSONS IN UPPER BRACKETS SO AS TO PUT MORE MONEY  
IN THE HANDS OF THOSE WITH GREATEST PROPENSITY TO  
SPEND CERTAINLY DOES NOTHING TO REDUCE INFLATIONARY  
PRESSURES. ON THE OTHER SIDE, IF GOVERNMENT TRIES  
TO TURN THE SCREWS TOO TIGHTLY, OR APPEARS TO BE  
RENEGING ON GISCARD'S CAMPAIGN PROMISES OF SOCIAL  
REFORM, THERE COULD BE WAVE OF SOCIAL UNREST WHICH  
WOULD RISK UNDERMINING STABILIZATION EFFORT. IT WILL  
REQUIRE GREAT AGILITY ON PART OF GOVERNMENT TO THREAD  
ITS WAY THROUGH THIS MINE FIELD SUCCESSFULLY.

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TRSE-00 PRS-01 SP-03 FEAE-00 OMB-01 SWF-02 DRC-01

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O R 211502Z JUN 74

FM AMEMBASSY PARIS

TO SECSTATE WASHDC IMMEDIATE 0151

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

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5. NEW PROGRAM SHOWS SEVERAL SHIFTS IN EMPHASIS  
COMPARED TO ECONOMIC POLICIES FOLLOWED PREVIOUSLY.

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(A) STATED HYPOTHESIS OF POMPIDOU-GISCARD MEASURES WAS THAT INFLATIONARY PRESSURES WOULD PEAK IN FIRST HALF OF 1974 AND THAT DURING SECOND HALF--EITHER THANKS TO RESTRAINT IMPOSED BY GOVT'S PROGRAM OR BECAUSE OF EXTRANEIOUS FACTORS, SUCH AS SOFTENING OF WORLD DEMAND FOR PRIMARY PRODUCTS--RATE OF FRENCH PRICE INCREASES WOULD MODERATE AND ANTI-INFLATIONARY CORSET COULD BE, AND PROBABLY WOULD NEED TO BE, LOOSENED. THIS SCENARIO HAS NOW BEEN SCRAPPED IN FAVOR OF ONE THAT CALLS FOR MAINTAINING TIGHT FISCAL AND MONETARY POLICIES WELL INTO 1975. INDEED, FINANCE MINISTER FOURCADE HAS RECOGNIZED THAT MEASURES ANNOUNCED LAST WEEK WILL NOT REALLY BEGIN TO MAKE THEMSELVES FELT UNTIL CLOSING MONTHS OF THIS YEAR, AND HAS FORESHADOWED ADDITIONAL STEPS IN THE FALL. IT IS LIKELY THAT THESE WILL BE PROPOSED WITHIN FRAMEWORK OF 1975 BUDGET, WHICH MUST BE SUBMITTED TO PARLIAMENT AT OPENING OF FALL SESSION IN EARLY OCTOBER. IT SEEMS CURIOUS IN THIS REGARD THAT LAST WEEK'S PROPOSAL TO INCREASE PERSONAL INCOME TAXES CONTAINS PROVISION FOR REFUND IN MIDDLE OF NEXT YEAR OF PART OF AMOUNTS COLLECTED. AT A MINIMUM WE WOULD HAVE EXPECTED REFUND TO BE MADE CONTINGENT ON SOME COOLING OFF OF INFLATION, RATHER THAN MANDATORY, AS IS APPARENTLY THE CASE.

(B) REAPPRAISAL OF ECONOMIC OUTLOOK FOR SECOND HALF OF 1974 HAS ALSO LED TO SHELIVING OF ANY PLANS FOR REDUCTION OF VALUE-ADDED TAX RATES LATER IN YEAR. (SHIFTING PUBLIC TRANSPORT SERVICES FROM INTERMEDIATE RATE OF 17.6 PERCENT TO REDUCED RATE OF 7 PERCENT,

WITH OFFSETTING INCREASE IN GASOLINE TAX, IS SPECIFIC STEP DIRECTED AS MUCH TO ENERGY CONSERVATION AS TO PRICE STABILIZATION.) THIS DECISION IS, IN OUR VIEW, CONSISTENT WITH REQUIREMENTS OF ANTI-INFLATION EFFORT. LAST YEAR'S MOVE TO CUT TVA PROBABLY DID NOT, IN THE END, CONTRIBUTE MUCH, IF ANYTHING, TO THAT OBJECTIVE, FOR IT MERELY LEFT MORE PURCHASING POWER IN HANDS OF THE PUBLIC. THIS BEING SAID, PRESIDENT GISCARD D'ESTAING IS KNOWN TO BE STRONGLY OF VIEW THAT OVER TIME, FRENCH TVA RATES MUST COME DOWN AND FRENCH TAX SYSTEM MADE TO RELY LESS HEAVILY ON INDIRECT TAX REVENUES THAN AT LIMITED OFFICIAL USE

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PRESENT. WE THUS FEEL CERTAIN THAT HE HAS ONLY PUT THIS PROJECT IN DESK DRAWER, NOT IN WASTE BASKET.

(C) NEW PROGRAM EXPLICITLY TAKES AS NEAR-TERM OBJECTIVE MODERATING OF BUSINESS EXPENDITURES ON PLANT AND EQUIPMENT, WITH INCREASED CORPORATE TAX BURDEN AND TEMPORARY TIGHTENING OF DEPRECIATION RULES BEING EMPLOYED TO THAT END. GOVT HAS VOICED HOPE THAT THESE STEPS WILL HAVE FAVORABLE INCIDENCE ON TRADE BALANCE BOTH BY DAMPENING FRENCH IMPORT DEMAND FOR EQUIPMENT GOODS AND BY SHIFTING FRENCH-PRODUCED EQUIPMENT AWAY FROM DOMESTIC MARKET INTO EXPORTS. THIS NEW POLICY LINE HAS BEEN ADOPTED NOTWITHSTANDING REPORTS THAT MANY PRODUCERS ARE BUMPING UP AGAINST THEIR CAPACITY LIMITS. IT IS ONE ELEMENT IN PROGRAM THAT SUGGESTS FRENCH AUTHORITIES MAY HAVE DOWNGRADED GROWTH SOMEWHAT IN THEIR SCALE OF PRIORITIES--AT LEAST TEMPORARILY.

(D) FINALLY, NEW PROGRAM ABANDONS CONCEPT THAT BECAUSE OF "LEVY" WHICH INCREASED OIL IMPORT BILL IMPOSED ON FRENCH NATIONAL WEALTH, THERE CAN BE NO ADVANCE IN REAL INCOMES NOR RISE IN FRENCH LIVING STANDARDS IN 1974. GOVT IS NOW SAYING THAT GROWTH IN AVERAGE OF REAL WAGES OVER NEXT TWELVE MONTHS SHOULD BE HELD TO ANNUAL RATE OF 2 PERCENT.

6. ONE DEVICE WHICH GOVT APPEARS TO BE BANKING ON TO HELP MODERATE UPWARD PROGRESSION OF MONEY WAGES IS PROPOSED ANTI-INFLATION TAX (PARA A(6) OF REFTTEL). SPECIFICS OF THIS MEASURE REMAIN VEILED IN MYSTERY. SERISE, ONE OF GISCARD'S IDEA MEN, DEVELOPED GENERAL CONCEPT, AND NOW FINANCE MINISTRY TAX EXPERTS ARE TRYING TO TRANSLATE IT INTO CONCRETE PROPOSAL. TECHNIQUE WOULD REPORTEDLY BE TO USE DATA GATHERED THROUGH TVA MECHANISM TO ESTABLISH WHAT PORTION, IF ANY, OF FIRM'S RECEIPTS WAS ATTRIBUTABLE TO SUCH INFLATIONARY FACTORS AS WAGE INCREASES IN EXCESS OF RECOMMENDED

NORMS OR INFLATED MARK-UPS BASED ON RISING COSTS OF

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TRSE-00 PRS-01 SP-03 FEAE-00 OMB-01 SWF-02 DRC-01

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O R 211502Z JUN 74

FM AMEMBASSY PARIS

TO SECSTATE WASHDC IMMEDIATE 0152

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

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RAW MATERIALS AND OTHER INPUTS. THIS EXCESS WOULD  
THEN BE SUBJECTED TO SPECIAL TAX. EVEN IN ITS BARE

OUTLINES, PROPOSAL HAS ALREADY RAISED APPREHENSIONS  
OF BOTH MANAGEMENT AND LABOR. IT WILL BE SUBMITTED  
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TO FALL SESSION OF PARLIAMENT AND, IF ENACTED INTO  
LAW, WOULD COME INTO EFFECT IN 1975. THUS, UNLESS  
ANNOUNCED AS HAVING RETROACTIVE EFFECT, IT WILL NOT  
BE A FACTOR IN SHORT RUN, WHEN SOME AMELIORATION  
IN RECENT EXCESSIVE PACE OF WAGE RATE INCREASES WOULD  
CERTAINLY BE WELCOME, AND MAY WELL BE CRUCIAL, IN  
SLOWING WAGE-PRICE SPIRAL.

7. 1974 TRADE DEFICIT, AS WE HAVE SAID, IS NOW  
PROJECTED TO BE AS HIGH AS \$6 BILLION. IN ABSENCE  
OF CORRECTIVE ACTION, 1975 DEFICIT WOULD DOUBTLESS  
HAVE BEEN OF SIMILAR MAGNITUDE. ONE WAY FRENCH  
AUTHORITIES PROPOSE TO SLASH DEFICIT IS THROUGH HOLDING  
DOWN OIL IMPORTS, WITH INCIDENCE OF REDUCED AVAILABI-  
LITIES TO BE IMPOSED LARGELY ON CONSUMPTION OF OIL FOR  
SPACE HEATING. FOREIGN EXCHANGE SAVINGS ARE ESTIMATED  
AT ABOUT \$1 BILLION. WITH LUCK--E.G., SOME MODERATION  
IN WORLD PRICES FOR OTHER PRIMARY PRODUCTS--THERE  
COULD BE FURTHER SAVINGS ON IMPORT SIDE. HOWEVER,  
MAJOR PART OF ADJUSTMENT NEEDED TO REACH EQUILIBRIUM  
RATE BY END OF 1975 WOULD HAVE TO COME THROUGH EXPANSION  
OF EXPORTS. FINANCE MINISTER HAS EXPRESSED HOPE  
THAT AS HIS STABILIZATION PACKAGE MODERATES DOMESTIC  
DEMAND, MORE FRENCH GOODS WILL MOVE INTO EXPORTS. HE  
SEEMS TO BE COUNTING ON ECONOMIC PICK UP IN COUNTRIES  
LIKE GERMANY AND U.S. TO PROVIDE MARKETS. HE DOES NOT  
APPEAR TO WORRY THAT ANTI-INFLATION EFFORTS ELSEWHERE  
MIGHT ADVERSELY AFFECT FOREIGN DEMAND FOR FRENCH GOODS.

8. THE LAST TIME FRANCE EXPERIENCED MAJOR EXTERNAL  
PAYMENTS DIFFICULTIES IN 1968-70, CORRECTIVE  
ACTION SUCCEEDED IN ERASING TRADE DEFICIT OF AROUND  
\$1 BILLION A YEAR IN LESS THAN 18 MONTHS AND IN PRODUCING  
\$1 BILLION TRADE SURPLUS FOR FOLLOWING 12 MONTHS. HOW-  
EVER, THAT RESULT REQUIRED NOT ONLY DOMESTIC STABILIZA-  
TION PROGRAM, BUT ALSO CUT OF ABOUT 11 PERCENT IN  
FOREIGN EXCHANGE VALUE OF FRANC. EVEN ALLOWING FOR  
FACT THAT ALL MAGNITUDES HAVE GROWN APPRECIABLY DURING  
INTERVENING FIVE YEARS, THIS COMPARISON HIGHLIGHTS THE  
IMMENSITY OF TASK FRENCH HAVE SET FOR THEMSELVES. WHILE  
WE CAN ENVISAGE SIGNIFICANT REDUCTION IN RATE OF DEFICIT  
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BY END OF 1975, WE HAVE GREAT DIFFICULTY IN SEEING  
HOW IT COULD BE ENTIRELY WIPED OUT BY THAT TIME.  
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## Message Attributes

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**Disposition Approved on Date:**  
**Disposition Authority:** golinofr  
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